



DEPARTMENT OF THE TREASURY

INTERNAL REVENUE SERVICE

TE/GE: EO Examinations

1100 Commerce Street, MC 4920 DAL

Dallas, TX 75242

501.03-00

**TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION**

March 7, 2012

Release Number: **201225016**

Release Date: 6/22/2012

LEGEND

ORG – Organization name

XX – Date Address - address

Taxpayer Identification Number:

Person to Contact:

Identification Number:

Contact Telephone Number:

ORG

ADDRESS

CERTIFIED MAIL

Dear

This is a final adverse determination regarding your exempt status under section 501(c)(3) of the Internal Revenue Code (the Code). Our favorable determination letter to you dated July 21, 19XX is hereby revoked and you are no longer exempt under section 501(a) of the Code effective January 1, 20XX.

The revocation of your exempt status was made for the following reason(s):

Organizations exempt from Federal income tax under section 501(c)(3) of the Internal Revenue Code are required to operate exclusively for charitable, education, or other exempt purposes. An organization is not operated exclusively for one or more exempt purposes unless it serves a public rather than a private interest. Treas. Reg. section 1.501(c)(3)-1(d)(1)(ii). During 20XX, we have determined that your organization served the private rather than public interest because a substantial purpose was to seek federal recognition of the unincorporated tribe of which your officers and office manager are also members.

Further, an organization is not operated exclusively for one or more exempt purposes if the net earnings of the organization inure in whole or in part to the benefit of private shareholders or individuals of the organization. See Treas. Reg. section 1.501(c)(3)-1(c)(2). During 20XX we have determined that your net earnings inured to the benefit of private individuals by regularly paying personal expenses of officers and your office manager without contemporaneously recording the expenditures as salary or

compensation. The funds inuring to your officers were substantial in comparison to total expenditures and activities and were multiple or repeated during the year. You have not implemented safeguards to prevent a recurrence of funds inuring to individuals. As such, you have not operated exclusively for exempt purposes and have operated for the benefit of private interests of individuals in contravention of the requirements of Treas. Reg. 1.501(c)(3)-1(d)(1)(ii).

Contributions to your organization are no longer deductible under IRC §170 after January 1, 20XX.

You are required to file income tax returns on Form 1120. These returns should be filed with the appropriate Service Center for the tax year ended December 31, 20XX and for all tax years thereafter in accordance with the instructions of the return.

Processing of income tax returns and assessments of any taxes due will not be delayed should a petition for declaratory judgment be filed under section 7428 of the Internal Revenue Code.

If you decide to contest this determination under the declaratory judgment provisions of section 7428 of the Code, a petition to the United States Tax Court, the United States Claims Court, or the district court of the United States for the District of Columbia must be filed before the 91st Day after the date this determination was mailed to you. Please contact the clerk of the appropriate court for rules regarding filing petitions for declaratory judgments by referring to the enclosed Publication 892. You may write to these courts at the following addresses:

You also have the right to contact the Office of the Taxpayer Advocate. Taxpayer Advocate assistance is not a substitute for established IRS procedures, such as the formal Appeals process. The Taxpayer Advocate cannot reverse a legally correct tax determination, or extend the time fixed by law that you have to file a petition in a United States court. The Taxpayer Advocate can, however, see that a tax matter that may not have been resolved through normal channels gets prompt and proper handling. You may call toll-free, 1-877-777-4778, and ask for Taxpayer Advocate Assistance. If you prefer, you may contact your local Taxpayer Advocate at:

If you have any questions, please contact the person whose name and telephone number are shown in the heading of this letter.

Sincerely,

Nanette M. Downing
Director, EO Examinations

Enclosure:
Publication 892



DEPARTMENT OF THE TREASURY

Internal Revenue Service
TEGE EO Examinations
55 N. Robinson, MC:4900
Oklahoma City, OK 73102-9229

September 19, 2011

ORG
ADDRESS

Taxpayer Identification Number:

Form:

Tax Year(s) Ended:

Person to Contact/ID Number:

Contact Numbers:

Telephone:

Fax:

Certified Mail - Return Receipt Requested

Dear

We have enclosed a copy of our report of examination explaining why we believe revocation of your exempt status under section 501(c)(3) of the Internal Revenue Code (Code) is necessary.

If you accept our findings, take no further action. We will issue a final revocation letter.

If you do not agree with our proposed revocation, you must submit to us a written request for Appeals Office consideration within 30 days from the date of this letter to protest our decision. Your protest should include a statement of the facts, the applicable law, and arguments in support of your position.

An Appeals officer will review your case. The Appeals office is independent of the Director, EO Examinations. The Appeals Office resolves most disputes informally and promptly. The enclosed Publication 3498, *The Examination Process*, and Publication 892, *Exempt Organizations Appeal Procedures for Unagreed Issues*, explain how to appeal an Internal Revenue Service (IRS) decision. Publication 3498 also includes information on your rights as a taxpayer and the IRS collection process.

You may also request that we refer this matter for technical advice as explained in Publication 892. If we issue a determination letter to you based on technical advice, no further administrative appeal is available to you within the IRS regarding the issue that was the subject of the technical advice.

If we do not hear from you within 30 days from the date of this letter, we will process your case based on the recommendations shown in the report of examination. If you do not protest this proposed determination within 30 days from the date of this letter, the IRS will consider it to be a failure to exhaust your available administrative remedies. Section 7428(b)(2) of the Code provides, in part: "A declaratory judgment or decree under this section shall not be issued in any proceeding unless the Tax Court, the Claims Court, or the District Court of the United States for the District of Columbia determines that the organization involved has exhausted its administrative remedies within the Internal Revenue Service." We will then issue a final revocation letter. We will also notify the appropriate state officials of the revocation in accordance with section 6104(c) of the Code.

You have the right to contact the office of the Taxpayer Advocate. Taxpayer Advocate assistance is not a substitute for established IRS procedures, such as the formal appeals process. The Taxpayer Advocate cannot reverse a legally correct tax determination, or extend the time fixed by law that you have to file a petition in a United States court. The Taxpayer Advocate can, however, see that a tax matter that may not have been resolved through normal channels gets prompt and proper handling. You may call toll-free 1-877-777-4778 and ask for Taxpayer Advocate Assistance. If you prefer, you may contact your local Taxpayer Advocate at:

If you have any questions, please call the contact person at the telephone number shown in the heading of this letter. If you write, please provide a telephone number and the most convenient time to call if we need to contact you.

Thank you for your cooperation.

Sincerely,

Nannette M. Downing
Director, EO Examinations

Enclosures:
Publication 892
Publication 3498
Report of Examination

Form 886A	Department of the Treasury - Internal Revenue Service Explanation of Items	Schedule No. or Exhibit R
Name of Taxpayer ORG		Year/Period Ended 20XX12

LEGEND

ORG - Organization name XX - Date City - city State - state
 Councilman - councilman ATTN - Attorney DIR-1, DIR-2 & DIR-3 - 1ST, 2ND
 & 3RD DIRECTORS CO-1, CO-2, CO-3, CO-4 & CO-5 - 1ST, 2ND, 3RD, 4TH & 5TH
 COMPANIES

ISSUES

1. Whether the ORG (to be called "the ORG") should have their exemption revoked for creating private benefit and inurement to the corporate officers of the exempt organization?

FACTS

The ORG is recognized as a section 501(c)(3) tax-exempt organization according to the determination letter dated April 19XX. According to its articles of incorporation, the primary activity of the organization is to promote American Indian culture and religion. The facts and circumstances show that the primary activity of the EO is to seek state and/or federal recognition as a tribe. The activities presented by the corporate officers of the ORG listed from largest to smallest include: Seeking state and federal recognition as an official Indian tribe, running genealogies of potential candidates for the tribe, working on creating Pow Wow to promote recognition of tribe, and holding meetings to discuss these issues.

The ORG is a corporation that was incorporated in the state of State on April 5, 19XX. The corporate founders were DIR-1, DIR-2, and DIR-3.. There was an ideological and physical split between DIR-3 and the other two founders DIR-1 and DIR-2. DIR-3 went behind DIR-2 and DIR-1's back and terminated the EO. DIR-2 and DIR-1 explained to the state of State that this was not a legal termination of the EO and the termination reversed. DIR-3 was voted out of the corporation and Councilman was promoted to a Councilman. The organization during the year that is being examined had DIR-1 (Vice President) and DIR-2 (President) as corporate officers and held the title of "headmen" for the affiliated tribe. Councilman was the office manager for the ORG for the year ending December 31, 20XX, and held the title of "Councilman" for the affiliated tribe. The affiliated tribe is a distinct different non entity from the exempt organization. The affiliated tribe has no powers or voting rights as to the corporation that is seeking state and federal recognition. The affiliated tribe does not have control over the use of the corporate funds.

During the year ending December 31, 20XX, the two corporate officers (DIR-1, DIR-2) and the office manager (Councilman) used exempt organization funds to pay for gas for personal vehicles, repairs to personal vehicles, meals, entertainment, and travel. There was no evidence of the organization maintaining an accountable plan.

There are 487 different entries for meals listed on the books during 20XX. The total cost of these meals was \$. That is an average of \$ per meal. When these expenses were questioned during the onsite interview, Councilman (the office manager of the ORG) stated that the purpose of the meals were for meetings. The exempt organization did not explain the purpose of the meeting nor did they provide whom the meeting was with, or why the meal was a lunch meeting and not a meal at the facility.

Form 886A	Department of the Treasury - Internal Revenue Service Explanation of Items	Schedule No. or Exhibit R
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There was \$ paid by the exempt organization for travel lodging. That is an average of \$ per day spent on motels and hotels. The records did not provide explanation of the exempt purpose of the travel. When these expenses were questioned during the onsite interview (DIR-1 the Vice President of ORG) told me that the lodging was for the office staff to come to City, State to meet with him, or for DIR-1 to stay in City, State to work at the headquarters of the ORG. In an IDR dated November 2, 20XX we requested a chronology of all exempt activities. The chronology written by the corporate officers and provided did not match the timing of the entries listed in the books.

There were 432 entries for the purchase of gas listed on the books. The total for these purchases was \$. The mileage logs were requested at the initial interview and onsite examination for the fuel purchases. The officers indicated that none were kept or created.

There were 91 transactions in the petty cash account (1010 CASH ON HAND) that were reported as cash, ATM VISA, or identified as the recipient's name. These transactions total to \$. The offset for these transactions are a single monthly cash distributions transaction that shows no detail. The transactions reported as ATM VISA are cash withdrawals from the use of debit cards by the two corporate officers. When these cash advances were questioned, the officers stated that the advances and draws for cash were for expenses occurred. The detail and purposes of these expenditures were not provided during the initial exam.

The books and records for ORG do not show any vehicles owned by the exempt organization. The books and records of the ORG do show repairs to vehicles. There was \$ in automotive repairs on the books for the year ending December 31, 20XX. When the repairs were questioned during the two week initial interview, the office manager Councilman stated they had to have transportation to do work for the exempt organization.

We took a sample of the account 5110 REPAIRS AND MAINTANANCE and pulled the receipts from the vendor CO-1. We reviewed the receipts to see what their exempt purpose was. All of the receipts failed to provide an exempt purpose. Most receipts did not have descriptions on them. The receipts included construction items including: circular saw, compound miter saw, 100 cords of wood, outdoor paint, and roofing materials. The receipts that did have descriptions stated ceremonial grounds. We asked the office manager Councilman twice if the ceremonial grounds had a structure on them. His answer was "No structure was on ceremonial grounds" both times. When asked if they planned to erect a structure, his answer was "Someday they may build something but no plans for the moment". The total for the account 5110 REPAIRS AND MAINTENANCE is \$.

LAW

Section 501(c)(3) of the Code exempts from federal income tax organizations organized and operated exclusively for charitable, educational, and other exempt purposes, provided that no part of the organization's net earnings inures to the benefit of any private shareholder or individual.

Form 886A	Department of the Treasury - Internal Revenue Service Explanation of Items	Schedule No. or Exhibit R
Name of Taxpayer ORG		Year/Period Ended 20XX12

Section 1.501(c)(3)-1(a)(1) of the regulations provides that in order to be exempt as an organization described in section 501(c)(3) of the Code, the organization must be one that is both organized and operated exclusively for one or more of the purposes specified in that section.

Section 1.501(c)(3)-1(c)(1) of the regulations provides that an organization will not be regarded as operated exclusively for exempt purposes if more than an insubstantial part of its activities is not in furtherance of exempt purposes.

Section 1.501(c)(3)-1(d)(ii) of the regulations provides that an organization is not organized or operated exclusively for one or more exempt purposes unless it serves a public rather than a private interest. Thus, it is necessary for an organization to establish that it is not organized or operated for the benefit of private interests such as designated individuals, the creator or his family, shareholders of the organization, or persons controlled, directly or indirectly, by such private interests.

Section 1.501(c)(3)-1(d)(1)(ii) of the regulations states that an organization is not organized or operated exclusively for exempt purposes unless it serves a public rather than a private interest. The regulation places the burden of proof on the organization to demonstrate that it is not organized or operated for the benefit of private interests such as designated individuals, the creator or his family, shareholders of the organization, or persons controlled directly or indirectly by such private interests.

Section 1.501(c)(3)-1(d)(2) of the regulations provides that the term "charitable" is used in section 501(c)(3) of the Code in its generally accepted legal sense, and includes the promotion of education.

The presence of a single substantial nonexempt purpose can destroy the exemption regardless of the number or importance of exempt purposes. *Better Bus. Bureau v. United States*, 326 U.S. 279, 283, 90 L. Ed. 67, 66 S. Ct. 112 (1945); *Am. Campaign Acad. v. Commissioner*, 92 T.C. 1053, 1065 (1989); see also *Old Dominion Box Co., Inc. v. United States*, 477 F.2d. 340 (4th Cir. 1973), cert. denied, 413 US 910 (1973) ("operating for the benefit of private parties who are not members of a charitable class constitutes a substantial nonexempt purpose"). When an organization operates for the benefit of private interests, such as designated individuals, the creator or his family, or persons directly or indirectly controlled by such private interests, the organization by definition does not operate exclusively for exempt purposes. *Am. Campaign Acad. v. Commissioner*, supra at 1065-1066.

In *B.S.W. Group, Inc. v. Commissioner*, 70 T.C. 352 (1978), the courts ruled the organization did not qualify for exemption under IRC section 501(c)(3) because it was not operated exclusively for charitable, educational, or scientific purposes.

Form 886A	Department of the Treasury - Internal Revenue Service Explanation of Items	Schedule No. or Exhibit R
Name of Taxpayer ORG		Year/Period Ended 20XX12

In order to be recognized as exempt under IRC section 501(c)(3), the organization is prohibited from:

- 1) permitting its net earnings to inure to the benefit of private individuals or operating in a way where more than an insubstantial part of its activities further private versus public purposes
- 2) engaging substantially in legislative activity
- 3) participating or intervening in any political activity

Treas. Reg. section 1.501(c)(3)-1(c)(2) states that an organization is not exclusively operated for one or more exempt purposes if its net earnings inure in whole or in part to the benefit of private shareholders or individuals.

Treas. Reg. section 1.501(a)-1(c) defines a "private shareholder or individual" as "persons having a personal and private interest in the activities of an organization."

If the private benefit to an individual or a group of individuals is greater than the public benefit, the private benefit is considered substantial. A substantial private benefit can result in revocation of exempt status.

Even a small amount of private inurement is fatal to exemption. In *Spokane Motorcycle Club v. U.S.*, 222 F. Supp. 151 (E.D. Wash. 1963), net profits were found to inure to private individuals where refreshments, goods and services amounting to \$825 (representing some 8% of gross revenues) were furnished to members

TAXPAYER'S POSITION

The position of the ORG is not known at this time.

GOVERNMENT'S POSITION

An organization recognized as exempt under IRC section 501(c)(3) is prohibited from permitting any of its net earnings to inure to the benefit of any private shareholder or individual.

Regs. 1.501(c)(3)-1(d)(1)(ii) states that the burden of proof is upon the organization to establish that it is not organized or operated for the benefit of private interests. This requirement applies equally to inurement and private benefit issues. While it is difficult to prove a negative, the organization is certainly in a better position than the Service to know the detailed facts surrounding its formation and operation. Therefore, in an exemption application case the organization is required to furnish the Service with the documents setting forth its purposes and rules of operation as well as a detailed explanation of its operations. See Rev. Proc. 84-46, 1984-1 C.B. 541.

In *John Marshall Law School and John Marshall University v. United States*, 228 Ct. Cl. 902 (1981), 81-2 U.S.T.C. 9514 involve classic channeling of an organization's net earnings to those in control. The court sustained the Service's revocation of the school's exempt status based on inurement. The court found inurement existed when the school provided the following to family members who were its officers:

Form 886A	Department of the Treasury - Internal Revenue Service Explanation of Items	Schedule No. or Exhibit R
Name of Taxpayer ORG		Year/Period Ended 20XX12

- * Interest free loans
- * Unsecured loans
- * Payments for non-business travel
- * Payments for non-business entertainment
- * Personal health spa membership

In *United Cancer Council, Inc. v. Commissioner*, 165 F.3d 1173 (19XX), the appeals court stated the inurement clause of IRC section 501(c)(3) interprets the phrase "private individual or shareholder" as an insider of the charity.

The court further said a charity must not improperly pass its earnings to its founder, board members, their families, or anyone else described as an insider who is the equivalent of an owner or manager. The insider could be an employee such as an office manager.

It is the government's position that the benefits the corporate officers incurred through fringe benefits and cash withdraws through use of debit cards is substantial. The corporate officers used their position as the caretaker of the moneys donated to the exempt organization to pay for their day to day lives. This would include repair of their personal vehicle, gas for travel, meals out, and rent of an apartment: Address, City, State.

The amount of the benefit is not clear due to the intermingling of personal expenses and exempt organizations functional expenses. What was determinable was that there is a comingling of these expenses and that there were no controls or accountable plans to separate personal expenses from the exempt organizations business. The exempt organization did not report these amounts as compensation on an original or amended Form 990, Form W-2, or Form 1099 for the year ending December 31, 20XX, before the start of this examination; nor did any of the corporate officers report these amounts as compensation on an original or amended Form 1040 before the start of this examination. Furthermore, the EO did not establish that its failure to report these amounts as compensation was due to reasonable cause within the meaning of section 301.6724-1 of the regulations, nor did it provide any other written documentation demonstrating that it approved these payments in accordance with established procedures set forth in section 53.4958-4(c)(3)(ii) of the regulations. The payments are described in detail below and on the attached documents.

MEALS

The EO has not provided any documentation to show that the 487 meals paid by the EO were for an exempt purpose. The receipts for meals paid for by the EO did not explain the need or the reason for these meals. The meals at times would be two or three per day and a large amount were in City, State or City, State, the home town of the EO or the home town of the Vice President of the EO. These meals do not meet the rules for fringe benefits Reg § 1.132-6(d)(2). Therefore it is the services position that these meals were excessive and were excess benefits to the corporate officers. Due to this excess benefit it is the service position that the ORG's exempt status should be revoked.

LODGING

Form 886A	Department of the Treasury - Internal Revenue Service Explanation of Items	Schedule No. or Exhibit R
Name of Taxpayer ORG		Year/Period Ended 20XX12

The EO has not provided proper documentation to show that the trips to various places across the south eastern part of the United States were for exempt purposes. The service requested a chronology of the trips and their purposes. The chronology does not match expenditures and their patterns. No evidence has been provided by the EO to show these transactions were for an exempt purpose. As an example the trip to Ft Walton, Florida was listed in the chronology created by the corporate officers as charitable planning. The chronology provided shows the trip from June 9 to June 13, 20XX on the chronology. The books show the trip from June 9 to June 16, 20XX. This would include a sub sequential payment for more nights on June 15, 20XX for more days at the CO-2 Inn in City, State. The charitable planning trip would include rides in glass bottom boats and other personal purchases that totaled \$. The room charges would include fourteen charges for small miscellaneous amounts that would add up to \$. Therefore, due to the questionable nature of the recorded trips on the CO-3; it is the services position that the road trips and lodging were excessive and were excess benefits to the corporate officers. Due to this excess benefit it is the service position that the ORG's exempt status should be revoked.

GASOLINE

The EO provided 432 entries on the books for gasoline. The ORG have no vehicles on their books and records. The EO did not provide any mileage logs and informed the agent that none existed during the two week initial exam. These expenses paid for with EO funds are not fringe benefits as per Rag § 1.132-6(d)(2), but excess benefits as per IRC section 4958(c). Therefore it is the services position that these purchases of gasoline were excessive and were excess benefits to the corporate officers. Due to this excess benefit it is the service position that the ORG's exempt status should be revoked.

REPAIR & MAINTENANCE

The ORG paid for repairs and maintenance for many vehicles. The EO does not have any motor vehicles on its books and records. Automobile repairs in the books were \$. Also in this account were multiple purchases from the home repair store CO-2. The EO does not have a structure to repair on its books. The receipts show miter saws and roofing materials (purchased by both officers). These purchases do not coincide with any activity listed on the chronology provided by the EO. The total for the account 5110 REPAIR AND MAINTENANCE is \$. It is the services position that these purchases are inurement as per IRC section 4958(c). Section 501(c)(3) of the Code exempts from federal income tax organizations organized and operated exclusively for charitable, educational, and other exempt purposes, provided that no part of the organization's net earnings inures to the benefit of any private shareholder or individual. Therefore, it is the service position that the ORG's exempt status should be revoked.

CASH ADVANCES

The ORG paid 91 cash advances or ATM withdrawals to the corporate officers DIR-2 and DIR-1 or the office manager Councilman for a total of \$. These transactions are recorded on the books as a withdrawal and are offset by a single monthly transaction. There was no existing

Form 886A	Department of the Treasury - Internal Revenue Service Explanation of Items	Schedule No. or Exhibit R
Name of Taxpayer ORG		Year/Period Ended 20XX12

expense reports showing a breakdown of the expenses occurred for each transaction or combination of the transactions. When the expense reports were requested for these withdraws during the two week initial exam, a box full of receipts was provided and there were no formal expense reports on the withdrawals that would constitute an approved accountable plan. It is the government's position that these withdraws are excess benefits and/or inurement to the aforementioned disqualified persons and are subject to IRC section 4958(c). Section 501(c)(3) of the Code exempts from federal income tax organizations organized and operated exclusively for charitable, educational, and other exempt purposes, provided that no part of the organization's net earnings inures to the benefit of any private shareholder or individual. Therefore, it is the service position that the ORG's exempt status should be revoked.

The ORG's primary activity is to seek out State and Federal recognition for their tribe. The list of names that was submitted to the Department of interior includes seven hundred names. These seven hundred names and the corporate officers will become the tribe if recognized by the State of State or the Federal Government. Further this recognition comes with the promise of government grants and subsidies if approved. Also if approved the ORG have a contract with a developer CO-4 (see signed resolution) for exclusive rights to possibly start up a casino with the corporate officers as the general partners. In the argument that the public is benefitted from the actions of the ORG, seven hundred applicants for the recognition of the ORG as a state and federally recognized tribe is very weak. It is the services position that this loose confederation of people with strong Indian blood lines does not meet the definition of the general public. Furthermore this group stands to benefit personally from any action performed by the corporate officers toward state and federal recognition.

In *Retired Teachers Legal Defense Fund, Inc. v. Commissioner*, 78 T.C. 280 (1982) The court denied exempt status in part because the entity failed the operational test based on presence of substantial private benefit. The 25,000 members was not a large enough class to constitute the "public."

In the case of the ORG it is the service's position that the private individual's benefit is substantial; it more than outweighs the public benefits. If the private benefit to an individual or a group of individuals is greater than the public benefit, the private benefit is considered *substantial*. A substantial private benefit can result in revocation of exempt status. Therefore, it is the services position that the ORG's exempt status must be revoked.

According to its articles of incorporation, the primary activity of the organization is to promote American Indian culture and religion. This may be a small by product of the EO, it is not the primary activity of the EO. The facts and circumstances show that the primary activity of the EO is to seek state and/or federal recognition as a tribe. All activities point to the corporation acting as a conduit for recognition for a listing of names with genealogical proof of having Cherokee blood. The ultimate goal of ORG is state and federal recognition. The EO is fighting other entities over the rights to these names. Payments to ATTN (lawyer) and CO-5 are for direct application for recognition or to fight for the rights of the list of names for declaring state and federal recognition. This act of itself inures to the members of the corporation. Recognition would enrich the corporate officers and their dependents.

Form 886A	Department of the Treasury - Internal Revenue Service Explanation of Items	Schedule No. or Exhibit R
Name of Taxpayer ORG		Year/Period Ended 20XX12

CONCLUSION

Regs. 1.501(c)(3)-1(d)(1)(ii) states that an organization is not organized or operated exclusively for exempt purposes unless it serves a public rather than a private interest. The regulation places the burden of proof on the organization to demonstrate that it is not organized or operated for the benefit of private interests such as designated individuals, the creator or his family, shareholders of the organization, or persons controlled directly or indirectly by such private interests.

Based on the foregoing reasons, the organization does not qualify for exemption under section 501(c)(3) and its tax exempt status should be revoked.